The Pensions Regulator
Making workplace pensions work

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Andrew Bailey
The Governor of the Bank of England
Threadneedle Street
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25 January 2024

Dear Andrew,

The Pensions Regulator's (TPR's) response to the Financial Policy Committee's (FPC's) Recommendations on Liability-Driven Investments (LDI)

I have set out below the summary of TPR's response to the FPC's recommendations on LDI.

Following the rapid and unprecedented increase in UK gilt yields in late 2022 that exposed vulnerabilities in LDI funds in which many pension schemes invest, the FPC made recommendations for TPR in its Financial Policy Summary and Record in March 2023. This built on the FPC's initial resilience policy recommendation of Q4 2022.

TPR has made significant progress to address these recommendations, working closely with Bank of England (BoE) and Financial Conduct Authority (FCA) colleagues. We recognise the role that pension schemes play in the complex financial services ecosystem, particularly as schemes continue to evolve in size.

I have themed the FPC recommendations into five key areas, the first three being LDI focussed, while the latter cover financial stability more generally.

1. TPR should take action to specify the minimum levels of resilience for the LDI funds and mandates.

In April 2023, within a month of FPC's statement, we published guidance [Using leveraged liability-driven investment | The Pensions Regulator] that specified the resilience regime, including the Bank's minimum 250bps stress buffer plus an operational buffer to manage day to day volatility, and expectations around recapitalisation, stress testing and governance.

Pension schemes are now more resilient to shocks. Pooled funds and segregated mandates have maintained overall levels of resilience consistent with the minimum levels recommended and have initiated recapitalisation at higher levels of resilience than previously (300-400 basis points).

2. TPR should continue its effective collaboration with other domestic and overseas regulators.

We are monitoring the aggregate picture of LDI resilience. We have built dashboards to provide a fuller market narrative to more efficiently spot compliance trends across both pooled and segregated mandates, the results of which we are due to start sharing in an automated report from February 2024, at which point we have agreed to take ownership for the data monitoring of LDI resilience. The dashboards will identify funds and bespoke LDI mandates at greatest risk of requiring a capital call over the next month under market stress situations.

It is important that there is a clear understanding of the roles TPR and the other regulators, such as BoE, FCA and overseas regulators, each play in monitoring LDI resilience and other emerging risks. Building on recent collaboration we are jointly documenting such operations.

3. LDI funds (for which we also read pension schemes) **should improve their operational processes to meet margin and collateral calls swiftly when needed.**

Market soundings suggest that the LDI crisis initiated a positive response by industry to improve operational controls of LDI funds and mandates, but we need further transparency over this. We have, therefore, significantly strengthened the leverage and liquidity data we are collecting in our annual Scheme Return which will be available for analysis in April 2024. We will survey the main investment consultants and a significant proportion of schemes in Q1 and Q2 2024 respectively to check that our governance and operational procedures are being implemented in line with our guidance.

This means that by Q3 2024, we will have an ever-richer resilience picture by being able to cross reference buffer levels with individual schemes' availability of liquid assets and their governance controls for replenishing the buffer at speed. Where we are not content that our guidance is being followed, we will be engaging the relevant schemes under supervision to address this, starting with those schemes that are likely to impact financial stability the most.

4. If TPR were to have regard to financial stability, it would need appropriate capacity and capability.

As part of the overall transformation at TPR, we are ensuring that our capable people are deployed in the right way, with appropriate focus on financial stability issues, and that our systems and processes support this. Improving capacity is also driven by better collaboration between regulators, improving relationships with market participants and enriched data capture.

Over the last year we have doubled the number of investment consultants. We are bolstering this with the recruitment of a senior economist, access to senior market participants to better gather market intelligence and understand some of the likely transmission mechanisms for potential emerging risks, and leadership of the function through a senior responsible officer.

5. TPR should have the remit to take into account financial stability considerations on a continuing basis.

It is for the Department for Work and Pensions (DWP) to consider whether we should have a formal objective on financial stability. Their response to the Work and Pensions Committee's report on LDI, states that "The Government accepts the FPC's recommendation that TPR should incorporate financial stability considerations in its decision making and balance them with its objectives as a pensions regulator".

We welcome this and can point to the above actions we have taken in having regard to financial stability and the work that we continue to progress. Financial stability is one of our key regulatory priorities in our corporate plan 2024-27. We will continue to collaborate with the BoE in the following areas:

- working with PRA colleagues to monitor any potential concentration risk arising from the transfer of pension schemes' liabilities to the insurance sector on buyout, and any consequences this may have on the demand for gilts;
- supporting the BoE on the system wide exploratory scenario which will help us understand how pensions schemes interact with the financial system when under stress;
- assist you with the development of a new lending tool that could be made available to eligible pensions schemes during periods of market dysfunction; and
- horizon scan areas where pension schemes could impact financial stability.

I look forward to continuing to engage with you on these important issues.

Yours sincerely,

Nausicaa Delfas

Chief Executive
The Pensions Regulator